

Internal Audit  
External Quality Assessment  
Presented to:

Wisconsin Employee Trust Funds

May 2018



IIA  
Quality  
Services, LLC

# Wisconsin Employee Trust Funds

It is our overall opinion that Internal Audit “Generally Conforms” with the *Standards* and the IIA Code of Ethics.

This level of conformance demonstrates a clear intent and commitment to achieving the Core Principles for the Professional Practice of Internal Auditing and the Definition of Internal Auditing

Governance	
Standard	Rating
1000	GC
1100	GC
1300	GC
Code of Ethics	GC

Staff	
Standard	Rating
1200	GC

Management	
Standard	Rating
2000	GC
2100	GC
2600	GC

Process	
Standard	Rating
2200	GC
2300	GC
2400	GC
2500	GC

Thank you for the opportunity to be of service to Internal Audit. We will be pleased to respond to further questions concerning this report and furnish any desired information.



  
 George Shemo, CPA, CFE  
 Team Leader  
 IIA Quality Services, LLC

  
 Tracy Darakjian, CIA  
 Director, Quality  
 IIA Quality Services, LLC



IIA  
 Quality  
 Services, LLC

Team Members:  
 David MacCabe, CIA, CGAP, CRMA, MPA

# Table of Contents

	Page
List of Acronyms	4
Executive Summary <ul style="list-style-type: none"><li>• Opinion as to Conformance with the <i>Standards</i> and the IIA Code of Ethics</li><li>• Objectives / Scope / Methodology</li><li>• Quality Assessment Process Map</li><li>• Observations Specific to Internal Audit</li><li>• <i>Standards</i> and IIA Code of Ethics Conformance Summary</li></ul>	5
Successful Internal Audit Practices Noted	10
Gaps to Conformance with the <i>Standards</i> Noted	13
Opportunities for Continuous Improvement Noted	16
Attachment A <ul style="list-style-type: none"><li>• Conformance Rating Criteria</li></ul>	18

# List of Acronyms

Acronym	Description
CAATs	Computer-Assisted Audit Techniques
CAE	Chief Audit Executive
Core Principles	Core Principles for the Professional Practice of Internal Auditing
EQA	External Quality Assessment
ERM	Enterprise Risk Management
IIA	The Institute of Internal Auditors
OIA	Office of Audit
IPPF	International Professional Practices Framework
IT	Information Technology
QAIP	Quality Assurance and Improvement Program
<i>Standards</i>	<i>International Standards for the Professional Practice of Internal Auditing</i>

# Executive Summary

# Executive Summary

Under the *International Standards for the Professional Practice of Internal Auditing* (“Standards”), an external quality assessment (“EQA”) of an internal audit activity must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The qualified assessment team who performed this EQA demonstrated competence in both the professional practice of internal auditing and the EQA process as required by the *Standards*. The Wisconsin Employees Trust Fund (ETF) internal audit activity (Office of Internal Audit) (OIA), in consultation with the Audit Committee (AC), selected IIA Quality Services, LLC (Quality Services) to provide the assessment. The onsite portion of the EQA took place during the week of May 21, 2018 and the final conclusions made by the independent assessment team were as of May 25, 2018 – the last date of the onsite portion of the EQA. Future changes in environmental factors and actions taken by personnel, including actions taken to address recommendations, may have an impact upon the operation of OIA in a manner that this report did not and cannot anticipate. Considerable professional judgment is involved in evaluating the findings and developing recommendations. Accordingly, it should be recognized that others could evaluate the results differently, and draw different conclusions.

## **Opinion as to Conformance with the Standards and the IIA Code of Ethics**

**It is our overall opinion that the OIA generally conforms with the Standards and the IIA Code of Ethics. This level of conformance demonstrates a clear intent and commitment to achieving the Core Principles for the Professional Practice of Internal Auditing (“Core Principles”) and the Definition of Internal Auditing.** A detailed list of conformance to individual *Standards* and the IIA Code of Ethics is provided within this report. Upon issuance of this report, OIA may use the terms “Conforms with the *International Standards for the Professional Practice of Internal Auditing*” or “Conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*”.

The IIA’s *Quality Assessment Manual* suggests a scale of three ratings, “generally conforms,” “partially conforms,” and “does not conform.” “Generally conforms” is the top rating and means the assessor or assessment team has concluded that the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the *Standards* and the IIA Code of Ethics in all material respects. Detailed definitions for rating criteria associated with “generally conforms”, “partially conforms”, and “does not conform” are described in Attachment A and are consistent with the guidance provided by the IIA in their *Quality Assessment Manual*.

## **Objectives of the EQA**

The principal objectives of the EQA were to (1) assess OIA conformance with the *Standards* and the IIA Code of Ethics; (2) assess the effectiveness of OIA in providing assurance and advisory services to the Audit Committee, senior ETF management, and other interested parties; and (3) identify opportunities, offer recommendations for improvement, and provide counsel to OIA for improving their performance and services and promoting their image and credibility.

# Executive Summary

## Scope of the EQA

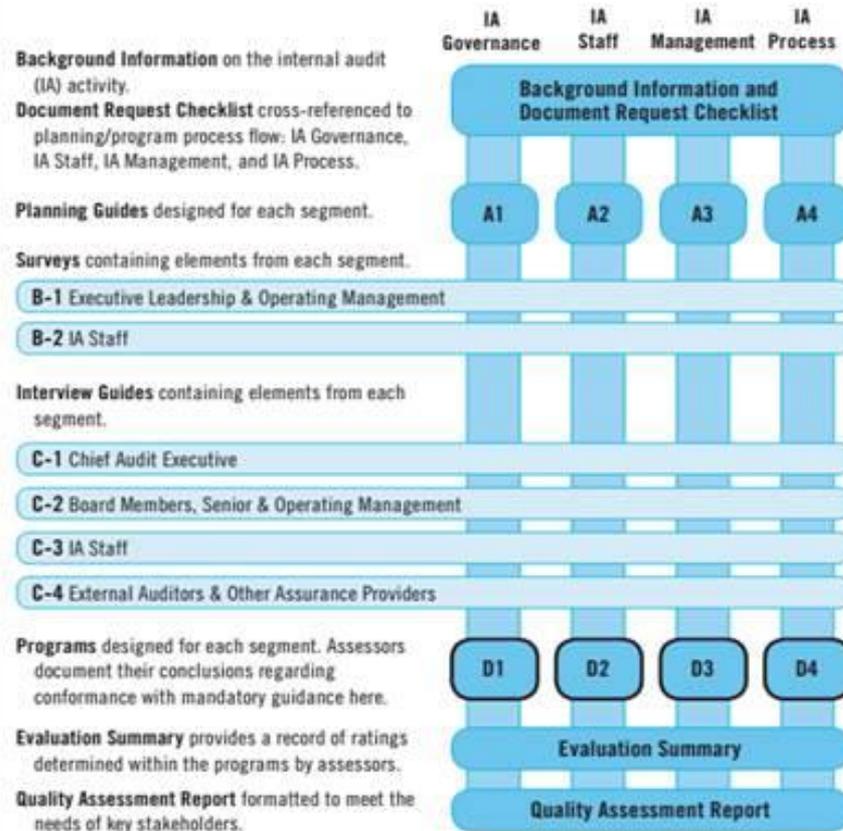
The scope of the EQA included the OIA, as set forth in the OIA Charter approved by the AC. The OIA Charter defines the purpose, authority, responsibility, and accountability of the OIA.

## Methodology of the EQA

To accomplish the objectives, the independent assessment team reviewed information prepared by OIA at the team's request; conducted interviews with selected key stakeholders of OIA including the AC chair, senior executives and operating management, the external auditors, and OIA management and staff; reviewed a sample of audit projects and associated work papers and reports; reviewed survey data received from executives and management; and prepared diagnostic tools consistent with the methodology established for an EQA in the IIA *Quality Assessment Manual*.

## QUALITY ASSESSMENT PROCESS MAP

Programs



# Executive Summary

## Observations Specific to Internal Audit

### Overall

OIA generally conforms with the *Standards* and the IIA Code of Ethics. This level of conformance demonstrates a clear intent and commitment to achieving the Core Principles and the Definition of Internal Auditing. OIA operates in a very dynamic environment with changing and emerging risks. Their ability to adapt and be responsive to change, combined with their ability to leverage insight on risks impacting the ETF into focused audit plans, will continue to be critical to their success and value to the organization. The CAE is establishing and executing a QAIP that demonstrates a commitment to continuous improvement and alignment with the *Standards* and the IIA Code of Ethics. The OIA annual planning process focuses activities in areas of risk identified with the input of senior management and the AC, consistent with the strategies and objectives of ETF. OIA is a critical component of the governance structure, and they appropriately monitor the effectiveness of risk management and control activities. Results of interviews and surveys of key stakeholders indicate that Internal Audit is highly valued by the AC and senior management.

### Attribute Standards

OIA has the infrastructure in place to support sustainability of internal audit processes in a quality and consistent manner. The OIA Charter is foundational to all their activities. OIA is functioning, in fact, with appropriate independence and objectivity; however, current ETF policy and the OIA Charter need to be revised to ensure the functional and administrative reporting relationships are properly defined, and clearly provide the appropriate appearance of organizational independence and objectivity. OIA management and staff collectively possess the knowledge, skills, and other competencies necessary to demonstrate professional proficiency. Work is performed with due professional care that includes an appropriate level of supervisory review and approval. OIA is embracing and is working to enhance the use of Computer-Assisted Audit Techniques CAATs to support risk assessment, planning, and continuous monitoring activities. The CAE is establishing and executing a QAIP that provides a strong basis to achieve continuous improvement and alignment with the *Standards* and the IIA Code of Ethics.

### Performance Standards

OIA is well managed, with effective processes and procedures that support consistency, quality, and sustainability. The annual audit plan is supported by a risk assessment process that incorporates input from OIA stakeholders, including the AC and ETF Board of Directors, and is linked to organization strategies, objectives, and risks. The CAE should take steps to revise the annual plan process and format to ensure OIA resource requirements, including the impact of any limitations, are properly communicated to senior management and the AC. Also, the CAE should use the revised process and format to communicate significant interim changes to the plan, to senior management and the AC. OIA resource levels and skill sets appear appropriate to meet annual audit plan objectives and risks, and OIA effectively uses third party resources for staff augmentation or specific subject matter expertise on an as needed basis. Periodic reports to senior management and the AC are of a high quality and appropriately communicate Internal Audit activities. Engagement level planning is supported by engagement level risk assessment to focus audit activities. Objectives evaluate technology, operational, financial, and compliance components as appropriate for individual engagements. Individual audits are of a consistent high quality and work papers fully support reported findings. Audit reports are consistent with the underlying work product and focus the reader on those areas of highest relevance. There is a follow-up process in place that tracks audit issues through to resolution.

# Executive Summary

## Standards and the IIA Code of Ethics Conformance Summary

	GC	PC	DNC
OVERALL	X		

ATTRIBUTE STANDARDS		GC	PC	DNC
<b>1000</b>	<b>Purpose, Authority, and Responsibility</b>	X		
1010	Recognizing Mandatory Guidance in the Internal Audit Charter	X		
<b>1100</b>	<b>Independence and Objectivity</b>	X		
1110	Organizational Independence		X	
1111	Direct Interaction with the Board	X		
1112	Chief Audit Executive Roles Beyond Internal Auditing	X		
1120	Individual Objectivity	X		
1130	Impairments to Independence or Objectivity	X		
<b>1200</b>	<b>Proficiency and Due Professional Care</b>	X		
1210	Proficiency	X		
1220	Due Professional Care	X		
1230	Continuing Professional Development		X	
<b>1300</b>	<b>Quality Assurance and Improvement Program</b>	X		
1310	Requirements of the Quality Assurance and Improvement Program	X		
1311	Internal Assessments	X		
1312	External Assessments	X		
1320	Reporting on the Quality Assurance and Improvement Program	X		
1321	Use of "Conforms with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	X		
1322	Disclosure of Nonconformance	X		

PERFORMANCE STANDARDS		GC	PC	DNC
<b>2000</b>	<b>Managing the Internal Audit Activity</b>	X		
2010	Planning	X		
2020	Communication and Approval		X	
2030	Resource Management	X		
2040	Policies and Procedures	X		
2050	Coordination and Reliance	X		

		GC	PC	DNC
2060	Reporting to Senior Management and the Board	X		
2070	External Service Provider and Organizational Responsibility for Internal Auditing	X		
<b>2100</b>	<b>Nature of Work</b>	X		
2110	Governance	X		
2120	Risk Management	X		
2130	Control	X		
<b>2200</b>	<b>Engagement Planning</b>	X		
2201	Planning Considerations	X		
2210	Engagement Objectives	X		
2220	Engagement Scope	X		
2230	Engagement Resource Allocation	X		
2240	Engagement Work Programs	X		
<b>2300</b>	<b>Performing the Engagement</b>	X		
2310	Identifying Information	X		
2320	Analysis and Evaluation	X		
2330	Documenting Information	X		
2340	Engagement Supervision	X		
<b>2400</b>	<b>Communicating Results</b>	X		
2410	Criteria for Communicating	X		
2420	Quality of Communications	X		
2421	Errors and Omissions	X		
2430	Use of "Conducted in Conformance with the <i>International Standards for the Professional Practice of Internal Auditing</i> "	X		
2431	Engagement Disclosure of Nonconformance	X		
2440	Disseminating Results	X		
2450	Overall Opinions	X		
<b>2500</b>	<b>Monitoring Progress</b>	X		
<b>2600</b>	<b>Communicating the Acceptance of Risks</b>	X		
IIA CODE OF ETHICS		X		

# Executive Summary

## Key Observations

The independent assessment team identified nine areas where Internal Audit is operating in a successful internal audit practice manner, three gaps to conformance with the *Standards*, and three opportunities for continuous improvement to enhance efficiency and effectiveness of Internal Audit processes or infrastructure. Detailed observations, recommendations, and OIA responses to the gaps to conformance with the *Standards* and opportunities for continuous improvement are included in the following section of this report.

### Successful Internal Audit Practices Noted

CAE successfully reorganized and transformed the ETF Internal Audit to add increased value, while following professional standards

OIA has strong support of the Audit Committee and senior management

OIA has implemented a well designed and highly effective QAIP

OIA has developed effective mutually-beneficial relationships with business partners

OIA has developed an excellent QAIP annual report with performance metrics for the Audit Committee and senior management

OIA has taken significant action to substantially implement the prior QAR recommendations

OIA has established excellent audit policies and procedures, which are well documented, and focused on conformance with IIA *Standards*

OIA engagement work papers are well structured and documented

OIA has implemented the use of audit engagement electronic software

# Executive Summary

## Key Observations

### Gaps to Conformance with the *Standards* Noted

<i>Standard 1110</i>	<b>Organizational Independence</b> – Revise ETF policy and the OIA Charter to ensure the OIA functional and administrative reporting relationships are properly defined, and clearly provide the appropriate appearance of organizational independence and objectivity.
<i>Standard 1230</i>	<b>Continuing Professional Development</b> – Strengthen OIA policies and procedures to manage and monitor staff continuing professional development.
<i>Standard 2020</i>	<b>Communication and Approval</b> – Revise the biennial planning process, including the plan format, to increase the amount of information and data regarding audit resource requirements.

### Opportunities for Continuous Improvement Noted

<i>Implementation Guide 1010</i>	<b>Recognizing Mandatory Guidance in the Internal Audit Charter</b> – Revise the IA Charter to include the definition of Internal Auditing and the Core Principles as part of the mandatory guidance.
<i>Implementation Guide 2010</i>	<b>Planning</b> – Consider retaining a consultant to assist OIA in developing more detailed IT elements within the “Audit Universe” to help further ensure the EFT IT environment is supported with appropriate resources.
<i>Implementation Guide 2030</i>	<b>Resource Management</b> – Consider scoping proposed audit engagements more narrowly, focusing on the key risk elements identified, and reducing the amount of audit staff time budgeted for audit projects.

# Detailed Observations

# Gaps to Conformance with the *Standards* Noted

Gaps to Conformance with the <i>Standards</i>	Internal Audit Response
<p><b>Standard 1110 Organizational Independence</b> – Revise ETF policy and the OIA Charter to ensure the OIA functional and administrative reporting relationships are properly defined, and clearly provide the appropriate appearance of organizational independence.</p> <p>According to current ETF policy and the OIA Charter, OIA reports both administratively and functionally to the ETF Secretary (CEO). While OIA does <u>in fact</u> function with complete independence, and has established a reporting relationship with the AC, the current formal structure partially impairs OIA independence <u>in appearance</u>.</p> <p><b>Recommendation</b> <i>The ETF Secretary, Board of Directors, and the AC should consider the following actions:</i></p> <ul style="list-style-type: none"><li>• <i>Formally establish the OIA functional reporting relationship directly to the AC, giving it the authority over and the responsibility for the ETF OIA.</i></li><li>• <i>Revise the AC Charter to require its approval of the CAE’s annual performance appraisal and annual salary, and any decisions regarding the hiring or dismissal of the CAE.</i></li><li>• <i>Meet privately in executive session with the CAE at the conclusion of AC meetings. At least annually, the AC should require the CAE to confirm OIA organizational independence.</i></li><li>• <i>Revise the OIA Charter to recognize its functional reporting line to the AC and its administrative reporting line to the ETF Secretary.</i></li><li>• <i>The AC should establish audit frequency guidelines that reflect the risk appetite of ETF, with the assistance of the CAE and the input of senior management.</i></li></ul>	<p>Management and the Audit Committee agree with the recommendation to strengthen the independence of the audit function. ETF is a state agency. Personnel matters related to the Audit Director are subject to state civil service rules. The Audit Committee will act, within provisions of those rules, to approve the hiring or dismissal of the OIA Director, including the hiring salary, and to perform the Director’s annual performance appraisal and recommend any appropriate salary adjustments.</p> <p>The Audit Committee (AC) is subject to the state’s Open Meetings Law. The AC will, consistent with that law, schedule appropriate time to meet with the Audit Director outside the presence of management to discuss any relevant matters of concern that Committee members may have.</p> <p>The AC will work with the senior management and the Audit Director to establish audit frequency guidelines that will reflect the risk appetite of ETF.</p> <p>The AC Charter will be revised to reflect the above proposed changes and will formally require the Audit Director to confirm OIA organizational independence. The current OIA Charter requires the annual independence affirmation to be confirmed to the AC in the December AC meeting annually by the Audit Director. The revised AC Charter will be submitted to the ETF Board for approval in the December 2018 Board meeting.</p> <p>The OIA Charter will be revised to recognize the Audit Director’s functional reporting line to the AC and administrative reporting line to the ETF Secretary. The revision will be submitted to the AC for approval at the December 2018 AC meeting.</p>

# Gaps to Conformance with the *Standards* Noted

Gaps to Conformance with the <i>Standards</i>	Internal Audit Response
<p><b>Standard 1230 Continuing Professional Development</b> - Strengthen OIA policies and procedures to manage and monitor staff continuing professional development.</p> <p><b>Recommendation</b></p> <ul style="list-style-type: none"><li>• <i>Develop a professional development plan with each staff auditor as part of the performance evaluation process.</i></li><li>• <i>Establish a policy requiring audit staff members to attain at least 40 credits of continuing professional education (CPE) per year. Training should be identified in the development plans.</i></li><li>• <i>Develop a process to monitor staff performance against the development plans.</i></li><li>• <i>Obtain relevant accounting, auditing, information technology, and pension fund reference books and publications.</i></li><li>• <i>Encourage staff members to participate in professional audit organizations.</i></li></ul>	<p>OIA agrees with the recommendations.</p> <p>OIA will add an Administrative Section in the OIA's Internal Audit Manual which will include policy and procedures that will address the continuing professional development issues raised by the IIA QA team. The Administrative Section will also include position descriptions, performance evaluations and other administrative matters.</p>

# Gaps to Conformance with the *Standards* Noted

Gaps to Conformance with the <i>Standards</i>	Internal Audit Response
<p><b>Standard 2020 Communication and Approval</b> – Revise the OIA biennial planning process and the format of the biennial plan submitted to senior management and the AC to increase data and information pertinent to communicating resource requirements, the impact of any resource limitations, and to serve as a basis to monitor significant interim changes.</p> <p>While the current OIA biennial planning process and format of the plan appropriately meet the requirements of <b>Standard 2010 Planning</b>, the data and information provided to senior management and the AC needs to be strengthened to provide them with an adequate basis to assess, understand, and provide proper oversight of the resources required to provide the proper audit coverage of ETF operations and processes.</p> <p><b>Recommendation</b> <i>Specifically, the CAE should consider the following actions:</i></p> <ul style="list-style-type: none"><li>• <i>Establish resource estimates (hours internally, and dollars for outsourcing externally) for each audit engagement proposed in the plan..</i></li><li>• <i>Provide a lump sum resource estimate for consulting engagements and special management requests..</i></li><li>• <i>Consult with senior management and the AC in developing audit frequency guidelines, based on risk prioritization. The guidelines should be approved by the AC.</i></li><li>• <i>Prepare multi-year plans that reflect the audit frequency guidelines.</i></li><li>• <i>Use the revised annual plan to report significant interim changes and any resource limitations to the AC and senior management.</i></li></ul>	<p>OIA will consult with the senior management and the AC to develop audit frequency guidelines and apply the guidelines in developing future audit plans.</p> <p>Future audit plans will include detailed resource estimates at the engagement level to indicate clearly the resources required for the proper audit coverage as determined by the frequency guidelines.</p> <p>Other recommendations are either currently in place or have already been implemented.</p>

# Opportunities for Continuous Improvement Noted

Opportunities for Continuous Improvement	Internal Audit Response
<p><b>Implementation Guide 1010 Recognizing Mandatory Guidance in the Internal Audit Charter</b> – While the OIA Charter does properly note the Mandatory Guidance of the IIA Standards and the Code of Ethics, reference to the Definition and the Core Principles needs to be added.</p> <p><b>Recommendation</b> Revise the OIA Charter to include the Definition of Internal Auditing and the Core Principles for the Professional Practice of Internal Auditing as part of the mandatory guidance.</p>	<p>OIA Agrees with the recommendations.</p> <p>The OIA Charter will be revised to include all the Mandatory Guidance. The revision will be submitted for the AC approval in the December 2018 AC meeting.</p>
<p><b>Implementation Guide 2010 Planning</b> – Consider retaining a consultant to assist OIA in developing more detailed IT elements within the “Audit Universe” to help further ensure the EFT IT environment is supported with appropriate audit resources. The current IT section of the audit universe may not be complete.</p> <p><b>Recommendation</b> A consultant could be utilized to assist the CAE in assessing and monitoring the work of external professionals conducting IT audit related services. This assistance would include reviewing engagement plans, work programs, work papers and reports of external consultants to ensure the scope, methodology, objectives, and reports of the engagements are consistent with the objectives of the OIA biannual Plan.</p>	<p>OIA Agrees with the recommendations.</p> <p>OIA will outsource IT related audit services when appropriate and utilize external IT audit consultant for IT audit scoping and monitoring in the future audit plan years.</p>
<p><b>Implementation Guide 2030 Resource Management</b> – Based on a review of the OIA biannual plan, current status reports, and management interviews, it appears that OIA will be unable to complete a significant portion of the planned activities. In large part this appears to be due to staff turnover and medical leave issues.</p> <p><b>Recommendation</b> Consider taking steps that might offset staffing issues by scoping proposed audit engagements more narrowly, focusing on the key risk elements that drove the project to the plan, and reducing the amount of audit staff time budgeted for audit projects. This should help avoid leaving projects open for extended periods until additional staff is available and provide management with more completed audits.</p>	<p>OIA Agrees with the recommendations.</p> <p>In developing the next biennial audit plan, engagement scope will be defined more narrowly to allow a quicker turnaround.</p>

# Attachment

# Attachment A

## Conformance Rating Criteria

**GC – “Generally Conforms”** means the assessor has concluded the following:

- For individual standards, the internal audit activity conforms to the requirements of the standard (e.g., 1000, 1010, 2000, 2010, etc.) or elements of the IIA Code of Ethics (both Principles and Rules of Conduct) in all material respects.
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity achieves general conformity to a majority of the individual standards and/or elements of the IIA Code of Ethics, and at least partial conformity to others, within the section/category.
- For the internal audit activity overall, there may be opportunities for improvement, but these should not represent situations where the internal audit activity has not implemented the *Standards* or the IIA Code of Ethics, has not applied them effectively, or has not achieved their stated objectives.

**PC – “Partially Conforms”** means the assessor has concluded the following:

- For individual standards, the internal audit activity is making good faith efforts to conform to the requirements of the standard (e.g., 1000, 1010, 2000, 2010, etc.) or element of the IIA Code of Ethics (both Principles and Rules of Conduct) but falls short of achieving some major objectives.
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity partially achieves conformance with a majority of the individual standards within the section/category and/or elements of the IIA Code of Ethics.
- For the internal audit activity overall, there will be significant opportunities for improvement in effectively applying the *Standards* or IIA Code of Ethics and/or achieving their objectives. Some deficiencies may be beyond the control of the internal audit activity and may result in recommendations to senior management or the board of the organization.

**DNC – “Does Not Conform”** means the assessor has concluded the following:

- For individual standards, the internal audit activity is not aware of, is not making good faith efforts to conform to, or is failing to achieve many/all of the objectives of the standard (e.g., 1000, 1010, 2000, 2010, etc.) and/or elements of the IIA Code of Ethics (both Principles and Rules of Conduct).
- For the sections (Attribute and Performance) and major categories (e.g., 1000, 1100, 2000, 2100, etc.), the internal audit activity does not achieve conformance with a majority of the individual standards within the section/category and/or elements of the IIA Code of Ethics.
- For the internal audit activity overall, there will be deficiencies that will usually have a significant negative impact on the internal audit activity’s effectiveness and its potential to add value to the organization. These may also represent significant opportunities for improvement, including actions by senior management or the board.